STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
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My name is Michael Salsbury, and I am the General Counsel of WorldCom, Inc.

The questions and issues that the Subcommittee seeks to address in this hearing – how accounting standards and federal policies may have contributed to the problems experienced by Global Crossing and the industry – are valid and important.

The competitive sectors of the telecommunications industry have experienced difficult times recently, primarily as a result of the failure of the Federal Communications Commission (FCC) and the Department of Justice (DOJ) to engage in timely and effective enforcement actions. Accounting issues also have contributed to the problems experienced by some companies. The Subcommittee is correct to be considering both federal policies and accounting issues at this hearing.

About WorldCom

Before specifically addressing questions posed by the Subcommittee in its invitation to testify, it may be of benefit to Members to have some background information about WorldCom.

WorldCom is a global telecommunications company with operations in more than 65 countries. In 2001, WorldCom had revenues of $35.2 billion and net income of $1.4 billion. Our global workforce of 85,000 employees is dedicated to developing and delivering a broad range of data and voice services to more than 20 million enterprise and consumer customers around the world.

WorldCom is a facilities-based carrier. In the last three years alone, WorldCom has invested more than $23 billion in its network. Today, WorldCom owns the world's most extensive and modern end-to-end data and voice communications network. We have wholly-owned facilities throughout North America, Latin America, Europe, the Middle East, Africa and the Asia-Pacific region, as well as ownership in private and consortium undersea cables.

By leveraging the strengths of its operating units – the WorldCom Group and the MCI Group -- WorldCom, Inc. continues to expand its market leadership in data, internet and international services, the growth drivers of the telecommunications industry:

- The WorldCom Group comprises the company's data, internet, managed and hosted solutions, international, and voice services for enterprise customers worldwide. WorldCom is the largest carrier of internet backbone traffic in the world. Also, WorldCom last year surpassed AT&T as the world's largest carrier of international traffic.
- The MCI Group comprises WorldCom's long distance and local consumer voice, wireless messaging, and wholesale private line and dial-up internet access businesses.

WorldCom's Accounting Practices with respect to IRUs

The Subcommittee's March 14, 2002 letter asked if WorldCom has engaged in "swap" transactions of indefeasible rights of use (IRUs) with Global Crossing and other carriers and, if so, how the value of these transactions was reported.

There has been a lot of press recently about "swap" transactions whereby carriers record revenue from "selling" capacity that is not likely to be used in return for a "purchase" of capacity that is not used and is capitalized rather than expensed. WorldCom does not participate in such transactions. WorldCom sells IRUs and occasionally purchases them where needed, but in all cases accounts for them appropriately.

An IRU is the right to exclusive use of a specified amount of capacity on a specific network facility for a specific term, generally the useful life of the facility. IRUs often are described as a "condominium-like" right. Prior to mid-1999, the general practice in the industry was to treat IRU sales like the sale of a condominium – the sales revenue was recognized in full when the transaction became effective and the appropriate fixed asset account was reduced by the cost of the facilities covered by the IRU. During June 1999, FASB Interpretation No. 43 was issued which, WorldCom was advised, effectively concluded that IRU sales generally should be treated as operating lease transactions with recurring revenue recorded ratably over the life of the IRU. During 2001, in accordance with FIN 43, WorldCom recorded recurring revenues of approximately $23 million (out of total revenues of $35.2 billion) from the sale of IRUs.

Although WorldCom is a facilities-based carrier, occasionally WorldCom does purchase IRUs from other carriers where we have a need, that is, in areas where WorldCom either does not have network or where our available network capacity is fully utilized. In those situations, WorldCom treats the purchase of an IRU just as it would a sale, that is, prior to mid-1999 WorldCom capitalized the cost of the IRU when it became operational and, after mid-1999 WorldCom expensed the cost of the IRU ratably over its term.

During December 2001, WorldCom entered into two IRU transactions with Asia Global Crossing (AGC). WorldCom purchased needed capacity on AGC's East Asia Crossing cable and AGC purchased capacity on WorldCom's Australia-Japan cable. Each transaction was for $20 million over a 10-year term. Because neither lease has yet become operational, WorldCom has not yet recognized either transaction on its P&L. As each IRU becomes operational, WorldCom will recognize approximately $0.5 million per quarter in revenue and expense over a 10-year period.

Unless otherwise disclosed by carriers, investors should expect that IRU transactions will be recognized by companies pursuant to accounting standards in effect at the time of the transactions.

Factors Contributing to the Industry's Problems

The Subcommittee also asked to what extent the following factors served as a "trigger" for industry problems:

- <u>Use of unique accounting standards and the issue of pro forma revenue projections</u>.
  WorldCom does not use unique accounting standards and does not issue pro forma revenue projections. As many companies do, WorldCom issues pro forma profit/loss statements to show the effect of acquisitions or of revenue from consolidated entities. WorldCom believes such statements assist investors in understanding the impact of certain transactions.

- <u>Invalid assumptions about the growth of capacity, leading to excessive debt levels</u>.
  It has become fashionable recently to blame the large number of failures in the competitive sectors of the telecommunications industry on bad planning. These claims – which generally emanate from the monopoly sectors of the industry and their pundits, but occasionally also from regulators – suggest that new entrants invested too much in new facilities and mis-forecast the demand for telecom services. There may well have been invalid assumptions by new entrants, but they related more to the expectation that federal regulators would fairly and vigorously enforce the telecommunications and antitrust laws than to assumptions about consumer demand. By repeatedly favoring monopoly interests and undermining competition, these regulators increased the costs for new entrants, which led directly to higher prices and lower consumer demand for local telephone services and high-speed data services such as DSL.

- <u>Federal telecommunications industry policies</u>.
  Congress established the right pro-competition policy direction in the historic Telecommunications Act of 1996. The Act was intended to open the Bell companies' local monopolies to vigorous competition – in particular to competition among the Bell companies themselves. The active involvement of federal and state regulators was a *sine qua non* in achieving the Act's goals. As noted, shareholders of competitive telecommunications providers and equipment manufacturers invested

billions of dollars in reliance that the law would be implemented and enforced as intended.

Instead, incumbent monopolies have successfully sabotaged the Act and federal enforcement efforts have been wholly ineffective:

- The Bell companies almost immediately embarked on a litigation strategy to frustrate and delay implementation of the Act. Six years after enactment of the Telecom Act, for example, we still do not have certainty over the prices Bell companies must charge for leasing unbundled facilities to competitors.

- The DOJ under Joel Klein consistently allowed the Bell companies to consolidate and expand their monopoly power through merger rather than to compete against each other as intended by the Telecom Act.

- The FCC under Bill Kennard and Michael Powell consistently has adopted policies that favored the interests of monopoly providers over competitive providers and failed to enforce existing policies designed to promote competition. When competitive DSL providers attempted to bring high-speed broadband services to residential and business markets, the FCC failed to enforce requirements that Bell companies unbundle their networks as required by the Act. When experience has showed that the only effective means to start competition in local telephone service is via UNE-Platform, or UNE-P, as permitted by the Act, the FCC responded by questioning whether UNE-P should be eliminated. Most recently, the FCC has proposed the development of rules that would lead to an effective duopoly of Bell companies and cable monopolies in the provision of high-speed data services, including internet access, to consumers. If adopted, this policy can only lead to higher prices, fewer competitive providers to buy from telecom manufacturers, and fewer choices for consumers.

The impact of these actions is apparent in the market capitalizations of a partial list of network and competitive local exchange companies (CLECs) over the last year:

	Market Cap (Mil.)		
	3/31/01	**3/19/02**	
Network Providers			
Broadwing Inc	$ 7,575	$ 1,662	
Flag Telecom Holdings Ltd	3,017	38	
Global Crossing Ltd	31,996	96	
Level 3 Communications	38,630	1,398	
Metromedia Fiber Network	26,327	54	
Williams Comm'n Group	24,049	79	
	$131,594	$ 3,327	-97%

CLECs	Market Cap (Mil.) 3/31/01	3/19/02	
Adelphia Bus. Solutions	$ 4,288	$ 3	
Allegiance Telecom	8,718	348	
Caprock Communications*	1,639	0	
Covad Communications	7,232	354	
Focal Communications	3,411	24	
ICG Communications	1,756	3	
Northpoint Communications	3,026	21	
McLeodUSA Inc	16,270	113	
Mpower Holding Corp	2,538	3	
RCN Corp	4,371	136	
Rhythms Netconnections	2,840	0	
Teligent Inc	3,696	0	
Time Warner Telecom	8,365	342	
US LEC Corp	1,094	80	
Winstar Communications	5,325	0	
XO Communications	16,901	23	
	$91,470	$ 1,450	-98%

These investor losses, and the associated job loss, did not result solely or even significantly from accounting issues. Nor were all these entrepreneurs poor planners.

WorldCom's Views on H.R. 3763

WorldCom is in the process of reviewing H.R. 3763 and would be pleased to offer its views to the Subcommittee when that review is completed.

Conclusion

The current problems in the competitive sectors of the telecommunications industry were not caused primarily or even significantly by accounting issues or assumptions about capacity utilization. Rather, those problems resulted directly from the unrelenting efforts of the Bell companies to retain their monopoly power and the fundamental failure of the FCC and the DOJ to properly and effectively implement and enforce the law.

In WorldCom's view, those failures have destroyed far more market capitalization and robbed far more value from shareholders' investments than any accounting issues.

Thank you.